

TESTIMONY of
Mr. Robert A. Stewart

“Patent Law Reform: Patent Quality Enhancement in the Information Economy”

BEFORE the
House Judiciary Committee Subcommittee Courts and Intellectual Property
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Introduction

Chairman Smith, Ranking Member Berman, and members of the Subcommittee, my name is Robert Stewart. I am the chief patent counsel at UBS AG for the Americas. I am pleased to testify today on behalf of The Financial Services Roundtable and BITS, which are affiliated financial services trade associations.

The Financial Services Roundtable (www.fsround.org) represents 100 of the largest diversified financial services companies providing banking, insurance, and investment products and services to American businesses and consumers. Member companies participate through their chief executive officer and other senior executives nominated by the CEO. Roundtable member companies account directly for millions of jobs.

BITS (www.bitsinfo.org) was created in 1996 to foster the growth and development of electronic financial services and e-commerce for the benefit of financial institutions and their customers. BITS provides intellectual capital and addresses emerging issues where financial services, technology and commerce intersect. BITS's Board of Directors is made up of the Chairmen and CEOs of twenty of the largest U.S. financial services companies, as well as representatives of the American Bankers Association and the Independent Community Bankers of America.

As you know, the financial services community is intensely interested in patent quality and litigation issues, and is grateful that you are considering these matters. The subject of today's hearings is "Patent Quality Enhancement in the Information-Based Economy".

It is, perhaps too easy and convenient to place the entire burden for patent quality on the staff of the U.S. Patent and Trademark Office ("PTO"). We believe that Commissioner Dudas and his staff continue to perform admirably to overcome the challenges facing the PTO including reducing the backlog of pending applications. However, the fact remains that over 800,000 applications¹ are pending at the PTO and Examiners are unable to spend enough time to provide a meaningful examination on complex applications.² As a result, patent quality has suffered, and patents of dubious quality threaten to injure inventors, licensors, licensees and to disrupt lawful economic activity.

My testimony will cover needed improvements in the areas of patent quality and litigation.

PATENT QUALITY

¹ U.S. PATENT AND TRADEMARK OFFICE, PERFORMANCE AND ACCOUNTABILITY REPORT FISCAL YEAR 2004, *available at* www.uspto.gov/web/offices/com/annual/2004/060405_table5.html (last visited April 27, 2005).

² FEDERAL TRADE COMMISSION, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY, A REPORT BY THE FEDERAL TRADE COMMISSION, October 2003, at 5.

Patent quality can be improved by (1) improving disclosure of relevant prior art to the PTO, (2) improving the quality of district court decisions in patent disputes, and (3) the inclusion of an effective post grant opposition proceeding with a second window. In addition, there are various other provisions that can be adopted which will make our patent system an effective and efficient mechanism capable of achieving its mandate to support our economic engine.

Improving Disclosure

The application process must be reformed to ensure that relevant art is disclosed in a meaningful way for Examiners that are pressed for time. Any examination of the PTO is only as reliable as the information that the Examiner is readily able to apply to the claims under review.

In furtherance of this goal, we are quite pleased that H.R. 2795 has a third party submission procedure, which will allow for more effective disclosure of relevant prior art to the Examiners at the PTO.

Improving Quality of District Court Patent Decisions

The quality of district court patent decisions can be improved by enhanced handling of claim interpretation issues between the district court and Federal Circuit and by funneling patent cases to judges that have the most experience handling patent disputes.

District court patent claim interpretations frequently are overturned by the Federal Circuit (e.g., 35% of district court claim interpretations were overturned from 1996-2003).³ The inconsistent claim interpretations between the district court and the Federal Circuit are representative of ways in which the current system has a deleterious impact and further erodes our Nation's limited judicial resources.

To further improve the efficiency of judicial resources, an interlocutory appeal to the Federal Circuit should be permitted after a *Markman* hearing. This new procedure would help to mitigate the judicial inefficiency that occurs when a full trial is conducted based on an incorrect interpretation of the patent at the district court proceeding and the Court of Appeals for the Federal Circuit modifies or reverses that interpretation and orders a new trial based on that modified interpretation or reversal. Litigants may end up paying for the attorney fees and expenses for two trials, instead of a single trial.

Patent Law Specialization in District Courts

Many district court judges have no special technical expertise, patent law experience, and very few have been admitted to practice before the U.S. Patent and Trademark Office. At law firms, patent attorneys specialize in patent matters and often hold engineering degrees. District court judges that hear patent disputes should be held to no less stringent standards than practicing patent attorneys in order to protect the public interest. Because the district courts and the Federal Circuit appear to be out of synch, appeals to the Federal Circuit are encouraged implicitly. U.S. district courts are not efficient, reliable or

³ Kimberly Moore, *Markman Eight Years Later: Is Claim Construction More Predictable?*, 9 Lewis & Clark L. Rev. 231 (2005).

ultimately "competitive" with specialized patent courts of various leading foreign countries (e.g., U.K., Germany, and Japan) with the largest gross domestic products (GDP's).

As an intermediate step to a single specialized district patent court, which may require additional funding and a lengthy approval process, our proposed venue language (set forth below) encourages preferential venue in the ten district courts that currently handle the most patent matters.⁴ These ten district courts could be further reduced gradually over time to a single specialized district court to ease the transition and prevent disruptions in the flow of litigation. If venue does not lie where a defendant resides under the new definition or in the preferential district courts, venue is proper consistent with general venue provision under 28 USC § 1391 (e.g., venue applied to foreign corporations with only personal jurisdiction in the U.S.). The proposed venue language allows broad unrestricted venue for federally funded universities to encourage their ability to enforce patent rights resulting from federally funded research. Accordingly, the status quo is preserved with the ability of federally funded universities to bring patent infringement suits in their choice of jurisdiction where there is personal jurisdiction.

We recommend replacing the current language of 28 U.S.C. §1400(b) with the following venue language to promote specialization in patent matters in 10 district courts, where 65% of patent matters are presently heard:⁵

"Civil actions, suits, or proceedings arising under any Act of Congress relating to patents may be brought (1) in the judicial district where the defendant resides, or (2) in any of the following federal district courts where the defendant is subject to personal jurisdiction at the time the action is commenced to foster judicial expertise in patent matters: Northern District of California, Central District of California, Southern District of New York, Northern District of Illinois, District of Massachusetts, District of Delaware, Southern District of Florida, Eastern District of Virginia, District of New Jersey, and the District of Minnesota. Notwithstanding the definition of resides under 28 U.S.C. §1391(c) "resides" under this section shall mean the judicial district where the defendant is registered as a business entity, incorporated or where its principal business office is located. If the plaintiff cannot bring a proceeding against a defendant under any of the patent venue provisions of this section in a patent matter or if the plaintiff is a university or college that has received federal funding within the last calendar year, or a non-for-profit organization controlled by such university, then the general venue provisions of 28 U.S.C. § 1391 shall apply to that patent matter."

LITIGATION

⁴ See, e.g., Kimberly A. Moore, *Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation*, 79 N.C.L. Rev. 934 (2001)(for information on selection of the ten district courts that handle the most patent matters).

⁵ Kimberly A. Moore, *Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation*, 79 N.C.L. Rev. 934 (2001).

Regardless of which factors contribute to a lack of patent quality, businesses of all shapes and sizes, including banks, broker-dealers, insurers and finance companies are threatened by a large and growing number of frivolous claims of patent infringement. Currently pending claims of infringement are a serious problem, but they are only the tip of the iceberg because of the lag in allowance of patent applications related to business methods and financial services. After the landmark decision in *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), the number of pending patent applications that involve financial services have surged generally.⁶ Because it typically takes more than three years to procure allowance of applications for business methods (e.g., Class 705),⁷ the risk of increased litigation for the financial services industry is now present.

While the Patent Act's provisions concerning injunctions and damages would need adjustment even if the Patent Office granted only valid patents, the patent quality problem makes the need for litigation reform all the more compelling. The possibility of a broad injunction and treble damages means that a financial services institution must take even the most frivolous patent infringement claim seriously. The current rules regarding injunctions and damages place all the leverage in the hands of the patent owner, even if the patent is extremely weak. If Congress does not correct the remedies under the patent law, the surge in the number of patents relating to financial services will lead to financial services institutions paying out ever-larger license fees to holders of suspect patents, to the detriment of our customers.

There are steps that Congress can and should take to provide financial firms and other businesses with additional safeguards against frivolous claims, without impairing the important protections afforded to intellectual property under the patent law. Many members of the Financial Service Roundtable are owners of Intellectual Property and we are as interested as anyone in protecting true innovation that benefits the economy and society as a whole. Specifically, Congress should:

- Modify the standard for injunctive relief;
- Clarify the damages rules with respect to willfulness and apportionment;
- Adopt a robust post-grant opposition proceeding; and
- Expand the scope of prior user rights.

Injunctive Relief

In most litigation contexts, the prevailing plaintiff bears the burden of showing that it is entitled to injunctive relief because money damages are insufficient. In patent cases, conversely, if the patent owner shows that a patent is valid and infringed, the court presumes that the patent owner is irreparably harmed by the infringement.⁸ In theory, the defendant has the opportunity to rebut this presumption, but as a practical matter, courts treat the presumption as virtually irrebuttable. The threat of a permanent injunction, even in the absence of any real irreparable harm, significantly increases the risk to a defendant

⁶ See, e.g., STEPHEN A. MERRILL, RICHARD C. LEVIN, AND MARK B. MYERS, NATIONAL RESEARCH COUNCIL, A PATENT SYSTEM FOR THE 21ST CENTURY, 2004 at 86 (prepublication copy).

⁷ *Id.* at 90.

⁸ *Jack Guttman, Inc. v. Kopycake Enters, Inc.*, 302 F. 3d 1352, 1356 (Fed. Cir. 2002).

of going to trial to prove invalidity or non-infringement. Accordingly, this presumption forces defendants to settle prematurely, even in cases with weak patents held by patent “trolls.”

In the past, the Second Circuit has held “the defendant manufactures a product; the appellant does not. In the assessment of relative equities, the court could properly conclude that to impose irreparable hardship on the infringer by injunction, without any concomitant benefit to the patentee, would be inequitable.”⁹ In other countries, including Canada and most European countries, injunctive relief is not available for paper patents that have not been worked. In the U.K., a party may apply for a compulsory license if the patentee fails to work the patent at any time after the expiration of three years from the date of the grant of the patent and if relevant grounds are satisfied.¹⁰

Rather than advocating a “working” requirement provision, we support the moderate step of amending Section 283 of the Patent Act to provide that a court should grant an injunction on a patent only if the patentee demonstrates that it is likely to suffer immediate and irreparable harm that cannot be remedied by the payment of money damages alone, as is the typical standard required for the issuance of an injunction. Only if an inventor can demonstrate a likelihood of irreparable harm should injunctive relief be available.

The Committee Print contained such language on irreparable harm. Unfortunately H.R. 2795, does not go as far as the Committee Print to clarify the standard of injunctive relief. Instead, H.R. 2795 implies that the defendant bears the burden of proof concerning irreparable harm, rather than the plaintiff. Still, the language of H.R. 2795 is an improvement over the status quo because it directs a court to “consider the fairness of the remedy in light of all the facts and the relevant interests of the parties....” Even if courts continue to presume that the harm is irreparable, this language makes clear that the presumption is rebuttable.

As many of you may know, this issue is now in front of the Supreme Court in the case of *MercExchange V. Ebay*.¹¹ However, a legislative solution that takes into account the full spectrum of opinions on this matter may prove a better and more permanent solution than case law.

Clarify the Damages Rules

The present patent law is subject to abuse by patent holders who go fishing for infringers, or worse, coerce law-abiding companies to pay large licensing fees. By simply sending a letter, at the cost of nothing more than a 39-cent stamp, a patent holder can set in motion a very costly process for the alleged infringer. The recipient of the letter has to undertake an investigation, incurring the cost of personnel time and legal counsel, both of which can be substantial. Failure to conduct the necessary due diligence could later subject the

⁹ *Foster v. American Mach. & Foundry Co.*, 492 F.2d 1317, 1324 (2d Cir. 1974)

¹⁰ Section 48(1), U.K. Patents Act of 2004.

¹¹ For background information, see *MercExchange L.L.C. v. eBay, Inc.*, 401 F.3d 1323 (Fed. Cir. 2005).

alleged infringer to treble damages. The accusing patent holder incurs no risk or cost, other than the cost of a stamp.

The patent law should be modified to provide that enhanced patent infringement damages may be awarded for any infringement only if: (a) the defendant received written notice from the plaintiff of a charge of infringement that identifies the specific patent, claims, and alleged infringing products or services at issue and that is sufficient to give the defendant an objectively reasonable apprehension of suit on the patent; (b) the infringer deliberately copied the patented subject matter with knowledge that it was patented; or (c) the patent was asserted against the infringer in a previous U.S. judicial proceeding, and the subsequent infringement is not materially different from the conduct asserted to be infringing in the previous proceeding.

At the same time, the Patent Act should make clear that enhanced damages should not be available with respect to any period during which the infringer had an informed good faith belief that the patent was invalid or unenforceable, or would not be infringed by the conduct later shown to constitute infringement. This informed good faith belief could be established by advice of counsel. Further, a patentee should not be able to plead willful infringement before a court has determined that the patent is valid and infringed by the defendant. We are pleased that H.R. 2795 contains provisions along these lines concerning willful infringement.

Another area of concern is the apportionment of damages when a patent covers a small component of a larger product. The Act should direct a court to award only the portion of the realizable value of a product that should be credited to the inventive contribution as distinguished from other features of product, the manufacturing process, business risk, or improvements added by the infringer. We are pleased that H.R. 2795 has appropriate language concerning apportionment.

Venue Reform to Curb Forum Shopping

We also urge you to consider an additional provision on venue reform that was not included in H.R. 2795. We previously mentioned venue reform in the context of promoting quality in the disposition of patent disputes within the district courts. Here, we further recommend limiting patent venue to curb the abuses of forum shopping in patent disputes. In general, with appropriate exceptions, patent cases should only be brought in the venue where the defendant is incorporated or in a limited group of district courts that specialize in patent matters, as opposed to anywhere there is personal jurisdiction against the defendant. Such a venue provision would prevent forum shopping and discourage frivolous litigation in patent disputes.

Under current law, plaintiffs and patent “trolls” can sue corporate business defendants for patent infringement anywhere the defendant is subject to personal jurisdiction because of the broad judicial interpretation of “resides” in 28 U.S.C. 1400.¹² In *VE Holding Corp.*, the Federal Circuit applied the broad definition of “resides” under the general venue statute of 28 U.S.C. 1391 to the patent venue statute of 28 U.S.C. §1400, which

¹² *VE Holding Corp. v. Johnson Gas Appliance Co.*, 917 F.2d 1574 (Fed. Cir. 1990).

effectively makes the patent venue limitations of 28 U.S.C. 1400 meaningless for corporate defendants. Instead, to give effect to 28 U.S.C. §1400, its patent venue language should control over the general venue language of 28 U.S.C. § 1391, with respect to patent matters.

Our proposed venue language limits venue to correct the broad definition of "resides" that currently allows corporate defendants to be sued in virtually any district court within the U.S. for patent infringement. The redefinition of "resides" is generally consistent with the pre-1988 standard for patent venue in which patent venue was favored in the state of incorporation or location of principle place of business. It is our understanding that such a limitation would discourage frivolous litigation (e.g., patent trolls). Professor Heller proposed similar venue language for H.R. 2795, which is equally acceptable to our proposal. However, any restriction of venue to reduce forum shopping should be supplemented with a move toward a specialized court for patent matters. To summarize, there are two benefits that can be gained from redefining venue: (1) limiting the applicable jurisdiction to a location that is convenient to the defending organization to discourage frivolous litigation and, (2) developing specialization and expertise in handling patent matters at the district court level, much like the Federal Circuit does at the appellate level.

The Prior User Rights Defense

The prior user rights defense under 35 U.S.C. 273 is an important protection for financial institutions especially due to the recent growth in patent litigation. However, in its current form, the prior user rights defense is merely limited to "business methods." Business methods have proved difficult to define in practice and are not defined anywhere in the Patent Act. Accordingly, a patent owner of a business method patent may characterize its business method as a system or apparatus to circumvent the application of the prior user defense. For this reason, the prior user defense should be modified to apply equally to methods and systems covered by a patent, as proposed in H.R. 2795. Further, we suggest that any bill strike the automatic provision of attorney's fees.

Another problem with the prior use defense is the high level of proof required to successfully assert the prior user defense. Currently, the prior user defense requires "clear and convincing evidence." Although "clear and convincing evidence" is generally appropriate where patent invalidity is invoked as a defense,¹³ here under the prior use defense the patent owner's patent is not invalidated and may continue to be enforced against third parties. The limited applicability of this personal defense to circumstances where the defendant's prior use was established before the invention thereof by plaintiff and the absence of patent invalidity supports changing the language of former Section 273(b)(4) from "clear and convincing" to "preponderance of the evidence."

Finally, the prior user right should be available to any entity that controls, is controlled by, or is under common control with the prior user. This is particularly important in the

¹³ Bausch & Lomb, Inc. v. Barnes-Hind/Hydrocurve, Inc., 796 F.2d 433 (Fed. Cir. 1986).

financial services industry, where companies tend to establish separate subsidiaries for the provision of new services because of the applicable regulatory framework.

Opposition Proceeding

The PTO proposed a post-grant review of patent claims in its 21st Century Strategic Plan that was released in 2002. We strongly support establishment of an opposition proceeding with a second window.

With respect to the first window, we recommend that the opposition procedure allow the public to petition the PTO to cancel one or more claims in a patent within 12 months of issuance (a timeframe supported by the Administration) under section 323. The counterpart U.K. opposition law provides for an opposition proceeding within 24 months after the date of grant,¹⁴ but the European Patent Convention opposition period is only 9 months.¹⁵ We respectfully suggest the creation of a reasonably moderate time frame of 12 months by changing the language of section 323 in H.R. 2795 from "9 months" to "12 months."

Further, with respect to a second window, we recommend allowing anyone who is threatened with a patent infringement action to file a request for an opposition proceeding within six months after receiving notice of the patent infringement action. Without the six-month window for initiation of an opposition proceeding upon a threat of patent infringement, the opposition proceeding would be seldom used. Organizations would not likely expend the resources necessary to monitor the patents of their competitors or the resources necessary to invalidate a patent in an opposition proceeding without any tangible economic return. However, an infringement action provides a sufficient economic incentive to use an opposition proceeding to avoid paying infringement damages for a questionable patent or a patent of suspect validity. Moreover, the 6-month window for launching an opposition would foster a more detailed scrutiny of patents than ordinarily occurs during the typical 25 hours or less of examination at the PTO.¹⁶ We are pleased H.R. 2795 contains this second 6-month window. However, whereas a first window shall be subject to a preponderance of evidence standard for a showing of invalidity, the second window could be generally subject to a clear and convincing standard for proof of invalidity, consistent with current treatment in trial court to foster efficient use of dispute resolution resources.

H.R. 2795 currently requires the new opposition proceeding to be stayed if the owner of the patent files an infringement action during the 9-month or 6-month windows for filing an opposition. This stay provision should be removed because it encourages costly litigation and allows the patent owner to control the opposition.

Conclusion

¹⁴ Section 72(2)(b) of the U.K. Patents Act of 2004.

¹⁵ EPC Art. 99.

¹⁶ FEDERAL TRADE COMMISSION, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY, A REPORT BY THE FEDERAL TRADE COMMISSION, October 2003, at 5.

The Financial Services Roundtable membership believes the U.S. patent process is fundamental to a healthy U.S. economy and robust free enterprise system. With increases in pending patent applications and claims of infringement, there is a need for Congressional debate and frank discussion with members of the financial services industry and the patent community at large. Given the importance of the patent process, the PTO should be fully funded without fee diversion and given adequate resources to perform its duties. At the same time, it is not enough for the PTO to turn out patents in greater quantity if those patents are not of the highest quality. I know that Director Dudas shares this view and we appreciate his dedication to patent quality issues. Moreover, because of increases in frivolous claims of patent infringement, we encourage you to continue your focus on appropriate defenses and other tools for litigation risk management, especially efforts to curb the use of injunctive relief.

We look forward to participating further as you develop and move legislation to improve the patent laws.